REGULAR MEETING

PUBLIC EMPLOYEES' RETIREMENT BOARD

JUNE 24, 2004

The regular meeting was called to order by President Teichrow at 8:30 a.m. Thursday, June 24, 2004. Roll call was taken with all members of the Board being present except Carol Carey, who was excused. Board members and staff present were:

Terry Teichrow, President
Robert Griffith, Member
Betty Lou Kasten, Member
Jay Klawon, Member
Troy McGee, Member
Jim Pierce, Member
Mike O'Connor, Executive Director
Linda Owen, Secretary

OPEN MEETING

Dale Taliaferro, AMRPE; Tim Jones and Sue Winchester, Great-West Retirement Services; Terrence M. Smith, Big Sky County Water and Sewer District; Jim Christnacht, Lorraine Reid, Angela McDannel, John M. Northey, Pam Fleisner, Tom Bilodeau, and Glen Leavitt, Employee Investment Advisory Counsel (EIAC); Kristi Rosseland, Office of Budget and Program Planning; Richard Cooley, Board of Investments; Tom Schneider, MPEA; Rick Ryan, Dan Cotrell, Kurt Bushnell, and Matt Norby, members of the Montana State Firemen's Association; and Ian Steel, Disability Claims Examiner; Kim Flatow, Member Services Bureau Chief; Roxanne Minnehan, Fiscal Services Bureau Chief; Carolyn Miller, Administrative Officer; Rob Virts, Training and Development Specialist; Barb Quinn, Accounting Supervisor; Linda Jensen, DC Accountant; and Diana Stitt, Payroll Benefit Technician-DC Plan, MPERA, joined the meeting.

MINUTES OF OPEN MEETING

The Executive Director presented the minutes of the open meeting of May 27, 2004. Mr. Klawon moved that the minutes of the previous open meeting be approved as amended. Mr. McGee seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Public Comment – Mr. Terry Smith spoke to the Board as a Defined Contribution Retirement Plan (DCRP) member. He had some questions about the budget, with respect to the administrative expenses allocated to the DCRP. What changes will be made? He pointed out the DCRP was being charged more than 6% of the total administrative expenses when the plan only makes up 3% of the membership. However, the anticipation was that participation in the DCRP was going to increase from 15% to 30%, but that participation rate did not come to pass. He noted the budget appears to allocate the expenses in the same fashion, with no notes showing that changes might be made to DCRP administrative expenses, or the administration of the DCRP.

Mr. Smith requested that the Board take immediate action and hire an outside consultant to review how the administrative functions are handled within the PERS program, with the specific idea of coming up with recommendations to bring those expenses in line in accordance with the number of participants in the plan, and making it more efficient.

Mr. Smith's second area of concern was the Plan Choice Rate (PCR), the impact on the employer, and the funding of the employees' retirement. According to Mr. Smith, the participants of the DCRP receive only 80% of the employee/employer contributions for funding retirement, as opposed to the participants in the DBRP who receive 100%. Based on that analysis, Mr. Smith views this as a clear violation of equal protection.

To further support his stand, Mr. Smith addressed the Colorado PERS that is implementing the DCRP for their members. They recognize there is a cost to the plan, with respect to the unfunded liability because of a portion of participants pulling out of the DBRP. Their stand was that the cost should be borne by the plan, and that the employer contributions from both the DB and DC participants should bear that cost. As a result, the employer also bears that cost because the employer contributions pays for the unfunded liability. The result of doing that is that the people who receive a benefit, which is a choice of having two plans within the retirement program that they have to choose from, as well as the employer who is providing the two plans and pays the cost of the unfunded liability. Both the DB and DC participant contributions are equal so there is no equal protection problem.

To fund the respective retirement plans (DB and DC) with equal employer contributions, and fund the unfunded liability that is a cost to have this choice for the participants, there is a question of whether equal protection is being violated. If a statute is harming, or putting an undue burden on a particular group of participants, Mr. Smith is asking the Board to give this issue consideration.

Mr. Smith's third concern was that, because of the discrepancy created by the DCRP, DB and DC participants are not receiving an equal benefit or equal compensation package as a result. So, he came up with the retirement plan equalization rate that could be funded through an employer match in the 457 plan.

EXECUTIVE DIRECTOR'S REPORT - Mike O'Connor

<u>Stable Value</u> **–** Aegon Institutional Markets in Louisville, Kentucky, is the largest Stable Value wrap over bond managers across the country. Chris Tobe gave a general background of Stable Value products, how components interrelate with one another, and the different options in the 401(a) and 457 plans. The MPER Board's investment manager, PIMCO, manages the portfolio. Aegon guarantees the book value benefit payments for participant withdrawals, and they also monitor the investment portfolio for guideline compliance.

Stable value rates give participants the feeling of saving rather than investing, and it is a vehicle that is very popular in defined contribution plans, in both the private and public sectors. Over 25% of all defined contribution money is now in stable value products; 40% of MPERA's participants are in the Stable Value.

Mr. Tobe reviewed book value accounting and the smoothing effect allowed in Defined Contribution plans. Anyone in a Stable Value Product gets full liquidity; their benefit is not "locked up." Aegon would provide the liquidity to give participants benefit responsiveness. Aegon does have limits on what they will or will not wrap.

The general guidelines of the industry are that people generally have typical high quality bonds under the stable value option. With the Board's investment guidelines, they have allowed some high yield bonds and securities. Duration is, basically, the average length of the bonds in the underlying portfolio. The longer the duration of a bond, the more volatile it is.

The duration of the Lehman Aggregate has been generally regarded as the upward limit on interest rate risk, maxing out at around 5.5 years. As of March 30, 2004, the average duration of the portfolio was at 3.5 years. The Board's current guideline for their portfolio duration range is plus or minus one year, not to exceed four years in a particular portfolio. He briefly touched on asset quality and the diversification of concentration limits. The minimum average portfolio quality is an A- rating; minimum issue quality is a BB- rating; minimum commercial paper quality is A2/P2; and below BBB- does not exceed 10%.

Mr. Tobe explained the process in determining the crediting rate and gave a feel for how crediting rates work and what would happen to the credit rate if interest rates went up or down in the future. Over the long haul, the crediting rate will be the underlying yield of the securities, but it is "smoothed" over a long period of time. The formula is, basically, the yield plus smoothing out the difference between market and book value over a period of time. The crediting rate is set every quarter.

Interest rates have gone down, in general, the last couple of years. In the Montana portfolio performance, the net crediting rate is 3.90%; the portfolio Account Equivalent Yield (AEY) is the underlying yield of 3.45%. The crediting rate is a little higher than the yield because the market value is a little higher than the book value. There are many dynamics going on, however, two dynamics have happened to the Board's crediting rate: 1) the overall interest rates have gone down; and 2) a major decision was made to go from a longer duration to an intermediate duration, which by definition, is going to lower the rate.

When interest rates go down, the market value of the bonds goes up, and vice versa. Stable Value has a smoothing process that uses the excess to keep the crediting rate up. This is a "point in time" calculation. It is the underlying performance of your manager, their underlying yield and the benchmark that drives this. If the duration was closer to 5 years, what effect would that have if the interest rates started to climb? The higher the duration, the higher the underlying yields on the portfolio. If interest rates went up, a 5-year duration portfolio would go down steeper in market value than the 3-year duration portfolio would. You would lose more on the market to book value. The longer duration portfolio is going to have more ups and downs, and the crediting rate will fluctuate more than a lower duration portfolio.

Mr. O'Connor noted that Scott Farris, with Arnerich, Massena & Associates, will be reviewing the investment portfolio for the purpose of looking at, specifically, the Board's Stable Value and the different options available, the investment guidelines, the different options to consider, or things to consider when adding or changing money managers.

Mr. Tobe reported that Aegon has certain guidelines that apply to durations. Their current wrap is designed to wrap around the current guidelines, which allow the high yield in exchange for the lower duration. Combinations can be very complex. Every plan is unique in the way it is designed. The longest duration they will allow, overall, in this portfolio, even if it was a 100% claim with one manager, is 5.5. They would have to get a 6% duration manager down to 5.5 before they could put a wrap over it.

With mixed managers, if the Board puts another manager in, Aegon cannot just mix and match the guidelines. That is not okay because the underlying things in the Board's current investment guidelines are riskier. The overall duration they would allow in a mixed portfolio would be somewhere between 4-5%. Their outward limit is 5.5, and that would be on the cleanest, most conservative portfolio. It can be very complex when trying to figure that out.

President Teichrow thanked Mr. Tobe for his informative presentation.

<u>Budget Report – FY 2005</u> – Roxanne Minnehan presented a proposed budget for FY 2005. Each June the Board approves the budget for the following fiscal year. The budget is divided into five categories:

- Defined Benefit
- Defined Contribution
- Deferred Compensation
- Defined Benefit Education Fund
- Defined Contribution Education Fund

The total budget of these funds represents the total administration of the MPERA. Each program has a different funding source. Defined Benefit expenditures are paid out of the defined benefit trust funds and statutorily limited to be no more than 1.5% of benefits. The Deferred Compensation and Defined Contribution Plans are structured to pay expenditures from fees charged to participants. The Education Funds are used to educate members of PERS. For FY 2005, contributions deposited into these funds will be .04% of employer contributions collected by each plan.

Expenditures are allocated based on FTE, percent, or actual cost to the program. When possible, expenses are identified as a DB, DC, 457, DBEd or DCEd expense. If nothing is identified, the expense affects all programs and is generally related to staff and is allocated based on FTE. Overall, the budget has increased 1% over last year, and the CPI increased 2.3%.

Mr. McGee would like to see a line item comparison of last year's budget and the proposed budget for FY 2005, so he can see what changes have been made. He would also like Mr. O'Connor to further research a new tape recorder that is needed.

The Legislative Auditor will be performing an audit that will include reviewing the allocation of expenses between the programs.

Mr. McGee made a motion to approve the Fiscal Year 2005 Budget, with a line item review in July. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Big Timber/Sweet Grass County Volunteer Fire Department – Late Filing of VFCA Annual Certificates – The Big Timber/Sweet Grass County Volunteer Fire Department, Companies A and B, are requesting the Board accept the Annual Certificates filed on December 24, 2003 for the fiscal year 2003. The Annual Certificates were signed by the fire chief and notarized. The appropriate training documentation was included.

Mr. Klawon made a motion that the Board uphold the staff determination that Big Timber/Sweet Grass County Volunteer Fire Department, Companies A and B, are eligible to receive credit and the members should receive credit for years of service as listed on the annual certificates for the fiscal year 2003. Mr. Pierce seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Legal Services Contracts – Each year the Governor's Office requires the PER Board to renew their legal services contracts.

Mr. Griffith made a motion to approve the Interagency Agreement for legal services with the Agency Legal Services Bureau, Montana Department of Justice. Mr. Klawon seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Mr. Klawon made a motion to approve the contract for legal services with Mona Jamison of the Jamison Law Firm. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Mr. Klawon made a motion to approve the contract for legal services with James Goetz of Goetz, Gallik & Baldwin, P.C. Mr. Pierce seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Town of Philipsburg – Interest Penalty – Samuel Brown was an employee of the Department of Corrections and a member of the Public Employees' Retirement System (PERS). In November 1994, he was elected to the position of Justice of the Peace. He terminated his position with the Department of Corrections on December 30, 1994, and began his employment with Granite County in January 1995. Mr. Brown was an active PERS member at that time and his PERS membership should have continued. He did not have the option to not elect PERS because he was a member through his employment with the Department of Corrections. Mr. Brown applied for and received a refund of his employment with Granite County. This error was corrected in April 2004. Granite County received a bill to correct the reporting error. This bill has been paid.

Mr. Brown went to work with the Town of Phillipsburg in November 1999. He was employed by Granite County at that same time. Retirement contributions were not withheld. A bill was sent to the Town of Philipsburg in April 2004, to collect all back retirement contributions and interest. The reporting error was discovered in April 2004 when Mr. Brown contacted MPERA to inquire on how he could become an active member.

Staff determined the membership of Mr. Brown was terminated in 1995 in error. Corrections followed with both Granite County and the Town of Philipsburg. The town of Philipsburg is requesting to have all interest charges waived.

Staff recommendation was that the Town of Philipsburg must remit the interest charges as required by statutes and ARM, along with Board Policy. In this particular case, Mr. McGee did not feel the Town of Philipsburg did anything wrong. Mr. McGee would like to change the rule so the Board has a little more flexibility in waiving interest. As things stand, he feels the Board must uphold the staff decision charging interest and denying the request from the Town of Philipsburg.

Mr. Klawon made a motion to uphold the previous staff decision, denying the request of the Town of Philipsburg to waive all interest charges in the matter of Samuel Brown. Mr. Pierce seconded the motion, which upon being submitted to vote, was duly carried with five of the attending members voting aye, and Mr. Griffith voting nay.

Future Board Meetings - Thursday: August 26 and September 23, 2004.

Operational Summary Report - The Executive Director presented an operational summary report for the month of June 2004, answering any questions Board members had.

The following portion of the meeting relates to matters of individual privacy. President Teichrow determined that the demands of individual privacy clearly exceed the merits of public disclosure. As such, this portion of the meeting will be closed.

CLOSED MEETING

MINUTES OF CLOSED MEETING

The Executive Director presented the minutes of the closed meeting of May 27, 2004. Mr. Pierce moved that the minutes of the previous closed meeting be approved. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

RETIREMENT REPORT - Ian Steel, Disability Claims Examiner

Disability Claims - The Disability Claims Examiner presented the disability claims for Board consideration. Mr. Pierce made a motion for approval of the disability claims as recommended for Joseph Chamberlain, with annual review; for Jacob Karp, Marie Yanc, Michael Skogen, William Robinson, Ernest Haakenson, Kenneth Carr, and Darlene Klem, without annual review; and denying the claims for Robert Frederick and Patrick Hansen. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Disability Reviews - The Disability Claims Examiner presented the disability review to the Board. Mr. Pierce made a motion to approve the disability review as recommended: to request an IME at the Board's expense for Gordon Barthel. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

Finalized Service/Disability Retirement Benefits, Monthly Survivorship/Death Benefits, and VFCA Lump Sum Death Benefit Payments - Applications for service retirements/finalized disability benefits, applications for monthly survivorship-death benefits, and VFCA lump sum death benefit payments were presented to the Board. Mr. Pierce made a motion to approve the retirement benefits as presented. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye.

CONTESTED CASES

Boni Braunbeck - Informal Consideration – In April 2002, Boni Braunbeck requested the cost to purchase one year of One-for-Five service. Three previous years of One-for-Five service had been purchased from June 1997 through December 2000. In March 2004, Ms. Braunbeck requested the cost to purchase another year of One-for-Five service. Upon reviewing the previous cost statement, it was noted that the cost was based on an incorrect service figure. Ms. Braunbeck was advised of the error and the subsequent balance due to complete this purchase. In accordance with 19-2-903, MCA, staff is required to correct this error. Without the correction, the service purchase must be adjusted.

Mr. Pierce made a motion that the Board uphold staff determination that the correction to the service purchase for Boni Braunbeck proceed. Ms. Braunbeck shall make payment for the balance due or accept proportional service credit. Mr. Griffith seconded the motion, which upon being submitted to vote, was duly carried with the seven attending members voting aye.

Kasey De La Hunt - Informal Consideration – The Guaranteed Annual Benefit Adjustment (GABA) was initially enacted in July 1997. With the increase changing to 3% and the waiting period dropping to 12 months, elections were again mailed to all active and retired FURS members in 2001. Mr. De La Hunt contacted MPERA in May 2004, after realizing he was not covered by the GABA. He is now asking consideration by the Board to accept a GABA election at this time.

Mrs. Kasten made a motion that the Board uphold the previous staff determination that the GABA correction for Kasey De La Hunt be denied. Mr. McGee seconded the motion, which upon being submitted to vote, was duly carried with five of the attending members voting aye, and Mr. Griffith voting nay.

Mrs. Kasten requested that management review the retirement statutes for consideration of redefining some of these problem areas through the general housekeeping bill.

City of Columbia Falls/Doug Peters - Informal Request – Doug Peters was involuntarily terminated from his position with the City of Columbia Falls on August 29, 2003. As a result of arbitration, Mr. Peters was reinstated to his position and awarded all back wages through April 30, 2004. The City of Columbia Falls is requesting that the Board become a party to the arbitration agreement and grant full service credit to Mr. Peters for the period between August 29, 2003 and April 30, 2004.

Mr. McGee made a motion that the Board grant the request of the City of Columbia Falls to be included as a party to the arbitration agreement for Doug Peters. Mr. Pierce seconded the motion, which upon being submitted to vote, was duly carried with the seven attending members voting aye.

ADJOURNMENT

There being no further business to come before the Board at this date, Mrs. Kasten made a motion to adjourn the meeting. Mr. McGee seconded the motion, which upon being submitted to vote, was duly carried with the six attending members voting aye. The next meeting is tentatively scheduled for July 22, 2004, at 8:30 a.m. in Helena.